VIRTUS FUNDS

Virtus Newfleet Low Duration Core Plus Bond Fund

A: HIMZX (92828W346) | C: PCMZX (92828W338) | I: HIBIX (92828W320) | R6: VLDRX (92828W197)

FIXED INCOME MARKET REVIEW

As we enter the home stretch of 2023, the economic transitions we expected to see are proceeding across the globe. China struggles with a slowing economy amid calls for more stimulus despite having exited its strict zero-COVID policies earlier this year. Europe, too, is wrestling with a slowing economy and inflation that remains above official targets. In the meantime, the U.S. economy has proven remarkably resilient—unlike other major world economies, it defied expectations of a slowdown, leading to a building consensus that the Federal Reserve (Fed) may pull off the often-elusive soft landing. The main risk to this scenario is the unpredictable cumulative effect of 18 months of monetary tightening on the economy. Monetary policy works on the economy with a lag, presenting a challenge to central bankers trying to return inflation to target without the associated economic pain of higher interest rates. We will be paying close attention to the labor market data in the weeks and months ahead to help inform our view on the likelihood of a soft-landing scenario.

Meanwhile, the ever-evolving situation with Russia and Ukraine trended in a more negative direction during the quarter as Russia declined to renew the grain transiting agreement, which may pressure food prices in the future. Additionally, oil price developments late in September should be monitored for any impact on forward-looking inflation expectations. Despite a weaker quarter of financial market performance, most participants continue to take the economic and geopolitical transitions in stride and seem to be embracing the view that any pain related to these changes would be shallow and short-lived. While Washington put its differences aside temporarily last quarter to address the U.S. debt ceiling, it is now faced with the renewed prospect of a shutdown in November as political differences continue to weigh on negotiations. The United Auto Workers union strikes against the big three automakers warrant attention as well. Both issues could potentially impact the economy depending on the length of disruption, though historically, the fallout from events like these tends to be only short-term in nature.

Financial market performance was weaker during the quarter as central bankers fought to tame ongoing inflation. We have seen significant progress on headline readings as supply chains healed, demand shifted from goods to services, and energy prices rebalanced. Core readings of inflation, however, remain stubbornly above targets. That said, the market expects that we are approaching the end of interest rate increases across most major global central banks. Evidence of this is found in the Fed's most recent summary of economic projections, which indicated one more rate increase. The Bank of England (BOE) has paused its rate hikes, while the European Central Bank (ECB) has signaled a pause. However, market expectations of a quick reversal of tighter policy have moderated, and the higher-for-longer narrative is taking hold. The Fed has tamped down expectations of rapid cuts in 2024 and 2025, and the ECB and BOE remain committed to the inflation fight, which may lead to their rates staying elevated for longer as well. There is clearly still work to be done on the inflation front.

With the backup in rates, most fixed-income sectors had negative total returns in the third quarter. A majority of spread sectors outperformed U.S. Treasuries and spreads tightened. Within spread sectors, shorter duration and risk asset classes outperformed. The U.S. Treasury curve shifted higher during the quarter and the curve steepened somewhat. The 2-year Treasury yield increased 15 basis points (bps), the 5-year Treasury yield increased by 45 bps, the 10-year Treasury yield increased by 73 bps, and the 30-year Treasury yield moved 84 bps higher.

We continue to see value being restored across most of the fixed income sectors in which we invest. Yields remain elevated and bond prices are broadly discounted. We expect the Fed will be successful in returning inflation to acceptable levels over time. We continue to watch data releases to inform our views on the global economic trajectory.

As the markets digest economic and geopolitical developments, we continue to believe active sector and issuer selection is critical to take advantage of market volatility as it arises. Our approach to fixed income—the approach we have implemented for over three decades—enables us to scan the bond market for the most attractive investment opportunities and is, in our view, ideally suited for the current environment.

For more detail on the macroeconomic backdrop and specific sectors, see Newfleet's 3Q23 Market Review & Outlook on Virtus.com.

FUND PERFORMANCE REVIEW

The Fund (Class I) returned 0.96% in the third quarter, outperforming the ICE BofA 1-5 Year U.S. Corporate & Government Bond Index's 0.29%.

Positive Contributors

> **Allocation and Issue Selection in Asset-Backed Securities (ABS):** Allocation to and issue selection within ABS had a positive impact on performance during the quarter. Attractive yields for short duration assets, inverted yield curve, good relative value, and strong demand were the key drivers of outperformance. Fundamentals are neutral—unemployment is still low at 3.8%, but delinquencies are trending higher across all consumer asset classes (i.e., autos and unsecured loans). The delinquency increase, however, is more pronounced for lower-scoring FICO borrowers.

> **Allocation to Non-Agency Residential Mortgage-Backed Securities (RMBS):** Allocation to RMBS over agency mortgage-backed securities (MBS) and positioning within the RMBS sector had a positive impact on performance. We continue to prefer non-agency residential exposure as credit performance remains stable, prepayments stay muted, and credit spreads are still wide of averages. With higher mortgage rates and a subsequent fall in housing activity, we see solid fundamental and technical backdrops.

> **Allocation to Bank Loans:** Allocation to bank loans had a positive impact on performance. Loans rallied early in the quarter on the back of growing expectations for a soft landing and limited new issue supply in the face of surging loan repayments. The market change in sentiment to a higher-for-longer view on rates has also led investors to reassess the space. With rates still rising, loans are outperforming investment grade and high yield.

Performance Detractors

> **Commercial Mortgage-Backed Securities Selection (CMBS):** Selection within the CMBS sector had a negative impact on performance during the quarter. The underperformance was primarily driven by one bond in our single-asset single-borrower (SASB) book of business. We see value in select CMBS but need to roll over a lot of stones to find it.

> **Bank Loans Issue Selection:** While the allocation to bank loans had a positive impact on performance, the higher-quality focus of holdings within the Fund detracted from performance as lower-quality cohorts within the sector outperformed during the period.

CURRENT FUND STRATEGY AND POSITIONING

> Reduced exposure to ABS, investment grade corporates, and RMBS.

> Increased exposure to agency MBS, cash, and U.S. Treasuries.

> In addition to changes to the Fund's sector allocation during the quarter, we continue to optimize positioning within sectors based on our view of the best relative value.

Emerging Markets (EM) Debt and Non-U.S. Exposure: Strength in EM continued in July, led by advances in the high yield portion of the index. August marked a reversal in returns as lower volumes and headlines on China's slowdown hurt the markets. While the new issue market opened up in the first half September, rate volatility and uncertainty dampened enthusiasm for EM, causing it to quickly shutter. Tighter valuations largely persisted throughout the quarter despite the lackluster returns. We continue to maintain our preference for hard currency debt and have no local currency exposure in the Fund. The Fund's positioning remains largely unchanged, with EM exposure at historical lows.

Investment Grade Corporates: Yields ended the third quarter at a year-to-date high, while spreads approached year-to-date lows. Nearly all industries tightened, with REITS and the energy complex faring the best. Banks continued to lag due to regional bank concerns and heavy supply. Autos, amid strike uncertainty, were the weakest-performing industry. Technicals are in the driver's seat as yield buyers made their presence known. Fundamentals are broadly stable. With weak to negative earnings growth, credit metrics took a small step backward but are expected to improve as growth resumes in the second half. Upgrades continue to dominate downgrades, though this ratio is starting to decelerate. We see buying opportunities in banking and utilities, both of which have lagged. An overweight to BBB-rated bonds remains prudent, especially considering the pace of ratings improvements within that category.

Corporate High Yield: The high yield market returns were slightly positive in the third quarter. Spreads tightened through July and remained rangebound until the last week of the quarter, when they widened about 25 bps and ended the third quarter 3 bps wider. As soft landing and higher-for-longer themes dominated the quarter, CCCs outperformed because they are less rate sensitive, more sensitive to a hard-landing scenario, and have higher carry. Housing and leisure continued to post strong results while chemicals and parts of healthcare remained weak. Credit fundamentals are staying strong, though they may have peaked in the first quarter, in our view. Despite high yield issuance volumes up 60% versus 2022, technicals remain favorable as net supply is still negative. During the quarter, we generally maintained exposure within the sector.

Securitized: Though total returns for securitized product were negative for the quarter, spreads for the asset class were marginally tighter versus U.S. Treasuries, thus generating positive excess returns versus risk-free assets. As rates rose, our exposure to short duration consumer-backed assets held up well. As in the second quarter, we continued to invest our marginal dollars into the more conservative parts of the capital structure as we get longer into the economic cycle. We maintained our overweight in ABS and RMBS while increasing our exposure to the agency MBS market as spreads reached historically wide levels versus their corporate investment grade counterparts. In our view, agency MBS afford our portfolios good liquidity and attractive yields. CMBS exposure is down slightly over the quarter but as the repricing within the commercial real estate market continues, we continue look for opportunities within the space.

OUTLOOK

Our multi-sector relative value approach enables us to take advantage of opportunities when events that trigger volatility, such as inflation worries or concerns surrounding the banking industry, affect valuations. In the current environment, we believe some of the best total return and yield opportunities can be found in spread sectors. However, given the risk of a recession, the Fund's exposure to spread sectors that would typically be more negatively impacted, such as corporate high yield and EM high yield, are at low levels relative to historical averages. Credit selection and positioning remain key. Specific sectors that demonstrate the best relative value for us include:

- Out-of-index/off-the-run ABS
- Non-agency RMBS
- BBB-rated investment grade corporates

The Fund maintains its higher-quality focus and short duration to limit both spread and interest rate volatility. As always, we aim to stay diversified, maintain granular positions, and emphasize liquid investments.

INVESTMENT ADVISER

Virtus Investment Advisers, Inc.

INVESTMENT SUBADVISER

Newfleet Asset Management

PORTFOLIO MANAGERS

David L. Albrycht, CFA
Industry start date: 1985
Start date as Fund Portfolio Manager: 2012

Benjamin Caron, CFA
Industry start date: 1997
Start date as Fund Portfolio Manager: 2012

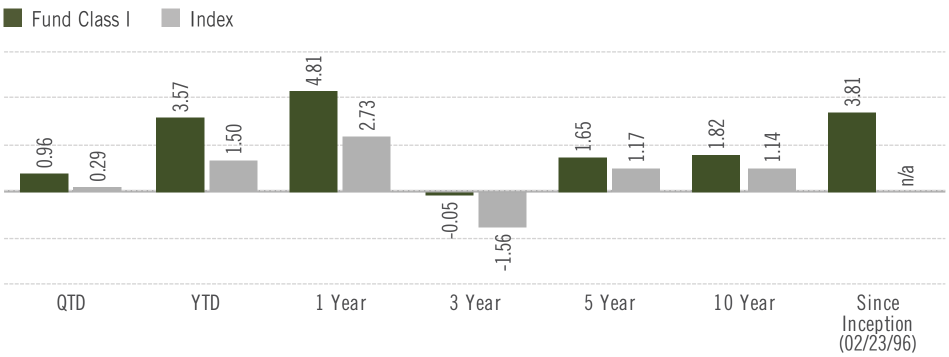
Lisa M. Baribault
Industry start date: 2003
Start date as Fund Portfolio Manager: 2017

SECTOR ALLOCATION

	% Fund
Asset Backed Securities	34.57
Corporate - High Quality	18.73
Non-Agency Residential MBS	18.40
Treasury	6.69
Bank Loans	6.25
Non-Agency Commercial MBS	5.87
Mortgage Backed Securities	3.85
Corporate - High Yield	3.57
Cash	1.48
Emerging Market - High Yield	0.59

Holdings and sector weightings are subject to change.

AVERAGE ANNUAL TOTAL RETURNS (%) as of 09/30/23



Performance data quoted represents past performance. Past performance does not guarantee future results. Investment return and principal value will fluctuate so that shares, when redeemed, may be worth more or less than their original cost. Current performance may be lower or higher than the performance data quoted. Please visit virtus.com for performance data current to the most recent month end. This share class has no sales charges and is not available to all investors. Other share classes have sales charges. See virtus.com for details.

The fund class gross expense ratio is 0.64%. The net expense ratio is 0.50%, which reflects a contractual expense reimbursement in effect through 1/31/2024.

Average annual total return is the annual compound return for the indicated period and reflects the change in share price and the reinvestment of all dividends and capital gains. Returns for periods of one year or less are cumulative returns.

Index: **The ICE BofA 1-5 Year US Corporate & Government Bond Index** tracks the performance of US dollar denominated investment grade debt publicly issued in the U.S. domestic market, including U.S. Treasury, U.S. agency, foreign government, supranational and corporate securities, with a remaining term to final maturity less than 5 years, calculated on a total return basis. The index is unmanaged, its returns do not reflect any fees, expenses, or sales charges, and is not available for direct investment.

Newfleet Asset Management is a division of Virtus Fixed Income Advisers, LLC ("VFIA"), an SEC registered investment adviser.

Notes on Risk: Credit & Interest: Debt instruments are subject to various risks, including credit and interest rate risk. The issuer of a debt security may fail to make interest and/or principal payments. Values of debt instruments may rise or fall in response to changes in interest rates, and this risk may be enhanced with longer-term maturities. **Foreign & Emerging Markets:** Investing in foreign securities, especially in emerging markets, subjects the portfolio to additional risks such as increased volatility, currency fluctuations, less liquidity, and political, regulatory, economic, and market risk. **ABS/MBS:** Changes in interest rates can cause both extension and prepayment risks for asset- and mortgage-backed securities. These securities are also subject to risks associated with the non-repayment of underlying collateral, including losses to the portfolio. **High Yield Fixed Income Securities:** There is a greater risk of issuer default, less liquidity, and increased price volatility related to high yield securities than investment grade securities. **Bank Loans:** Bank loans may be unsecured or not fully collateralized, may be subject to restrictions on resale, may be less liquid and may trade infrequently on the secondary market. Bank loans settle on a delayed basis; thus, sale proceeds may not be available to meet redemptions for a substantial period of time after the sale of the loan. **Market Volatility:** The value of the securities in the portfolio may go up or down in response to the prospects of individual companies and/or general economic conditions. Local, regional, or global events such as war or military conflict, terrorism, pandemic, or recession could impact the portfolio, including hampering the ability of the portfolio's manager(s) to invest its assets as intended. **Prospectus:** For additional information on risks, please see the fund's prospectus.

The commentary is the opinion of the subadviser. This material has been prepared using sources of information generally believed to be reliable; however, its accuracy is not guaranteed. Opinions represented are subject to change and should not be considered investment advice or an offer of securities.

Please consider a Fund's investment objectives, risks, charges, and expenses carefully before investing. For this and other information about any Virtus Fund, contact your financial professional, call 800-243-4361, or visit virtus.com for a prospectus or summary prospectus. Read it carefully before investing.

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